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COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, JANUARY 14, 1999

APPLICATION OF

VIRGINIA ELECTRIC AND
POWER COMPANY

CASE NO. PUE980462

For Approval of Expenditures
for New Generation Facilities
pursuant to Va. Code § 56-234.3 and
for a certificate of public
convenience and necessity pursuant to
Va. Code § 56-265.2

ORDER

On August 11, 1998, Virginia Electric and Power Company ("Virginia Power" or "Company") filed the instant application (the "Application"), requesting regulatory approval for the construction of five new gas-fired turbine generator units of approximately 150 megawatts ("MW") capacity each, to be installed either at a site in Caroline County or a site in Fauquier County. A related application seeks regulatory approval for construction of transmission facilities necessary to connect these generators to the electric transmission grid.

The Application has been twice amended. First, Virginia Power sought to increase the number of units from five to six, and also to utilize both sites. Later, in its rebuttal testimony, the Company modified the request to seek authority to construct only the first four units, using only its site in

Fauquier County. It is proposed that the 4 units would begin operation on or about July 1, 2000.

On September 2, 1998, the Commission Staff ("Staff") moved for a ruling as to whether the Rules Governing the Use of Bidding Programs to Purchase Electricity from Other Power Suppliers, now codified at 20 VAC 5-301-10 ("Rules"), were applicable to Virginia Power's filings. Pursuant to the Commission's order, also issued on September 2, 1998, the Company filed its response to the motion on September 16, 1998, and replies to this response were filed by other interested parties and by the Staff.

Virginia Power's response to the motion stated that it no longer had either an active bidding program or a long term resource plan, and so was not subject to the Rules, but if the Commission found otherwise, requested an exemption from the Rules. The Company asserted that the "critical need in 2000 and 2001 for extensive capacity warrants an exemption" for its Application, and that the Application could not be "accommodated within a competitive bidding process because of the quick timetable." The Company requested the Commission grant an exemption from the Rules "in order to assure the timely availability of this peaking capacity in 2000."

On October 20, 1998, the Commission issued an order establishing a procedural framework within which to resolve the

issues raised by Staff's request for a ruling and the responses filed. The Commission found that an expedited hearing should be convened to determine, "the need for capacity and how any need can best be met, whether the Bidding Rules are applicable and if so whether Virginia Power should be granted an exemption from them, and whether the Virginia Power's asserted 'quick timetable' can accommodate meaningful participation from other parties." To encourage meaningful participation by other potential energy suppliers, the Commission further directed Virginia Power to file, "documents and materials necessary to enable interested parties to determine whether, if there is a need for additional capacity, they can meet such need through construction or purchase of generating capacity, demand side measures, or otherwise." A number of parties did respond to our order of October 20, 1998, by prefiling an intent to bid or testimony indicating their interest in submitting bids for capacity that the Commission may ultimately find to be needed by Virginia Power.¹

The Commission convened a public hearing on January 5, 1999, which concluded three days later after receiving testimony

¹ Florida Power & Light filed notice of its intent to bid and Verified Declaration. Other parties presenting testimony indicating an interest in submitting bids included Edison Mission Energy, LG&E Power, Dynergy Power Corp., Westmoreland Energy Inc., and Calpine Corporation. Westvaco and the Virginia Independent Power Producers indicated an interest in extending existing power contracts. Additionally, Ingenco, a small scale provider of distributed generation capacity, provided testimony through Public witnesses.

from five witnesses for Virginia Power, eight witnesses from other power producers, a witness for the Attorney General, and two Staff witnesses. The witnesses testifying on behalf of potential bidders gave few specific details on their individual proposals to provide peaking capacity. Thus, the record is unclear as to whether timely bids could be received after the hearing and, if so, whether such bids would be under the benchmark pricing established by Virginia Power's construction proposal. We understand the reluctance of these parties to disclose the competitively sensitive details of their potential bids.

In addition to evidence of potential bids, the prospect for greater market power concentration resulting from Virginia Power constructing the requested gas-fired turbine generator units was also addressed by witnesses for the Attorney General, Staff, Old Dominion Electric Cooperative and the Virginia Independent Power Producers.

We will begin with an analysis of the Rules and the reasons for their promulgation to determine their applicability to Virginia Power today.

The Commission promulgated the Rules by order dated November 29, 1990, in Case No. PUE900029.² This case was established because:

issues relative to the bidding process, including the propriety of an exclusive bidding program and the proper weighting of utility construction compared to purchase options, have arisen in a number of recent certificate and arbitration proceedings filed with this Commission. The growing use of bidding programs and the questions raised in those several proceedings resulted in our determination that it was necessary to initiate this investigation to revisit the principles discussed in the January 1988 Order and to adopt clear rules to delineate a framework for the contracting process between utilities and other power suppliers, both qualifying facilities under PURPA and non-PURPA independent power producers.

The Commission concluded in this order that "bidding programs continue to provide electric utilities with an excellent option for acquiring necessary capacity in an orderly and reasonable manner," and that a utility that establishes such a program "should be free to refuse offers of capacity that have been received outside of its bidding program."³

² Commonwealth of Virginia, ex. rel State Corporation Commission, Ex Parte: In the matter of adopting Commission rules for electric capacity bidding programs, 1990 S.C.C. Ann. Rep. 340. The Commission had earlier announced policy guidelines regarding utility capacity bidding programs in Commonwealth of Virginia, ex. rel State Corporation Commission, Ex Parte: In the matter of adopting Commission policy regarding the purchase of electricity by public utilities from qualifying facilities when there is a surplus of power available, Case No. PUE870080, 1988 S.C.C. Ann. Rep. 297, Final Order, January 29, 1988 ("January 1988 Order").

³ 1990 S.C.C. Ann. Rep. 340. Rule IX codifies this statement.

In the January 1988 Order, the Commission noted it had instituted the proceeding "to consider questions surrounding the acquisition of additional generating capacity by electric utilities." A comprehensive review of this subject was needed "as a result of the contention by one of the state's major utilities, Virginia Power, that it was receiving capacity offers in amounts greater than its projected needs for the foreseeable future."⁴

Both the guidelines and the Rules were intended to impose some structure in utility capacity acquisition at a time when federal law⁵ and regulations had caused numbers of new participants to respond to a newly created opportunity to market power to traditional utilities. Prior to the implementation of the Rules, utilities were required to accept capacity offers from qualifying facilities and small power producers whenever they had need for capacity additions and to establish the price for such purchases at the utility's "avoided cost" on a case-by-case basis. Soon, both Virginia Power and this Commission were embroiled in numbers of protracted and contentious negotiations. Hence, the Rules established the important *quid pro quo* that utilities that established bidding programs could refuse offers

⁴ 1988 S.C.C. Ann. Rep. 297.

⁵ The Public Utility Regulatory Policies Act of 1978, 16 U.S.C. 2601 et seq., ("PURPA").

received outside the bidding program. With limited exceptions, all capacity acquisition was to be conducted through the utility's bidding program. The bids themselves, compared against the utility's benchmark cost of building the capacity itself, which by rule it must determine, established an acceptable proxy for avoided costs.

In the January 1988 Order, the Commission stated that it "envision[s] a system in which a utility determining a need for additional power would issue, probably on an annual basis, a form of 'Requests for Proposals,' ("RFP") identifying its requirements in broad general terms, and the factors to be used in selecting projects to meet those needs. Participants in the market would evaluate this RFP in light of their own best interests and respond accordingly." The Commission cautioned utilities to "guard against the temptation to make an RFP overly restrictive in terms of the types of projects which could reasonably meet the threshold requirements. It is important that the process give a fair opportunity to all participants."⁶

It is unquestioned that Virginia Power established and maintained a bidding program. The record is replete with references to various RFPs issued by the Company over the years. At no time has Virginia Power advised the Commission or the

⁶ 1988 S.C.C. Ann. Rep. 298 (footnote 3).

interested public that it has abandoned its bidding program, which would re-open its obligation to accept capacity offers. If at any time Virginia Power intends to formally abandon its bidding program, then the Company is directed to file with this Commission its notice of election to do so. Included in such notice shall be a complete description of the Company's methodology for determining its avoided costs under PURPA. This methodology will be in lieu of the use of competitive bids for determining avoided costs.

While Virginia Power has not issued an RFP recently, it requested and received waivers of the Rules as recently as 1996 and 1997.⁷ Further, its witness, Mr. Rigsby, testified during the hearing that on the day the Application was filed, August 11, 1998, the utility intended to "go to the market" for at least 264 MW of additional capacity, and would go to the market by issuing an RFP.

The Commission concludes that the Company's contention that it could solicit competitive bids for power without regard for

⁷ Application of Virginia Electric and Power Company, For a Certificate of Public Convenience and Necessity Pursuant to Va. Code § 56-265.2 and Joint Application of Virginia Electric and Power Company, Richmond Power Enterprise, L.P. and Enron Power Marketing, Inc., For authority to enter into a purchased power contract without competitive bidding, Case No. PUE960062, Final Order, November 18, 1996. Application of Virginia Electric and Power Company, Virginia Power SPC-1, Inc., Virginia Power SPC-II, Inc. and Cheasapeake Paper Products Company, For issuance of Certificates of Public Convenience and Necessity Pursuant to Va. Code § 56-265.2 and related regulatory approvals, Case No. PUE950131. The exemption was granted in a 1997 Commission order that was later withdrawn.

or compliance with the Rules is unfounded and untenable. We find that Virginia Power presently has an active bidding program.

It is similarly unreasonable for the Company to contend as it did in its responsive pleading filed September 16, 1998, that it has no long-term resource plan as contemplated by the Rules. Rule III states that any utility's need for capacity identified in an RFP "should be consistent with its long-term resource plans. The capacity need identified by an investor owned electric utility should be consistent with the resource plans filed most recently with the Commission." Virginia Power subsequently acknowledged through its witnesses Cartwright and Green that the capacity need identified in this proceeding is consistent with Virginia Power's most recent long-term resource plans and consistent with its plan "filed most recently with the Commission."

The Rules apply.

We turn now to the request for an exemption from the Rules. We will deny this request. Virginia Power's reason for the exemption is that the Rules cannot accommodate the "quick timetable" for adding the capacity in the year 2000.

In testimony filed with the Application, Virginia Power witness Cartwright asserted that unit construction must begin on the site selected approximately one (1) year in advance of the

planned in-service date for the units. This in-service date is July 1, 2000.⁸ Mr. Cartwright, in ore tenus testimony during the hearing disclosed, however, that construction in the form of site preparation should begin by April 1, 1999.⁹ While this date was challenged as too early, the procedures that this Order will implement are designed to, and will, accommodate the Company beginning work on the Remington site on April 1, 1999, as proposed.

Concerning the Company's timetable, evidence was brought forward during the hearing that in 1988, while also soliciting bids for peaking capacity, Virginia Power had issued an RFP on November 15, 1988, for capacity with an in-service date of December 31, 1989. Thus, the period from issuance to capacity availability was 13 1/2 months for the 1988 RFP. July 1, 2000, is roughly 18 months from now. No persuasive reason was offered to show that bids for supply of the July 1, 2000, capacity could not reasonably be received and evaluated on a timetable that would accommodate this schedule.

During the hearing, as noted, Virginia Power revealed both that it had finalized the contract for the purchase of the six

⁸ Exh. WRC-6, at 4.

⁹ We note, however, that the April 1, 1999, date for beginning site preparation does not appear in the Company's Application or Supplemental Application, nor in its direct, supplemental, additional supplemental, or rebuttal testimonies.

CTs¹⁰ and also that it intends to soon "go to the market" with an RFP. Its last reported intent is to solicit bids for 264 MW of capacity for July 1, 2000, as well as bids for about 850 MW for July 1, 2001, and July 1, 2002. Virginia Power's intent to solicit bids for power delivery on July 1, 2000, indicates its belief that even its "quick timetable" can be accommodated within the Rules for some increment of capacity. We are not persuaded from the evidence that a solicitation for the 600 MW of capacity represented by the units it asks to build cannot also be accommodated. Delivery of both increments of capacity will fall due on the same date.

To the extent that there is time pressure present in this case, the responsibility for such lies squarely with the Company. Further, the record supports and the Rules require that others be permitted an opportunity to supply some or all of the Company's identified peaking capacity requirements.

We are also mindful of the valid concerns over increased market power expressed by Staff, the Attorney General, Old Dominion Electric Cooperative, and others on cross examination. We share their concern that our approval of the proposed construction program will increase the Company's generation market power just when the Commonwealth may undertake to provide

¹⁰ Further, the Company disclosed that it had not finalized its construction contract for installation of the units.

retail customer choice. In light of these market power concerns, we believe it appropriate for this Commission to encourage new entrants into Virginia's electricity market.

Therefore, we will order the Company to issue an RFP for at least the entire increment of capacity needed by July 1, 2000, and we direct our Staff to oversee the immediate development of the RFP and to review the Company's evaluation of all responses to it. The Staff is also directed to report any irregularities or complaints about the procedures promptly to the Commission for our further consideration. At the hearing, the Company indicated that its RFP would be ready in a matter of days. Accordingly, the Company should, no later than January 19, 1999, at noon, deliver to the Staff its proposed RFP and the Staff will promptly review and amend the proposal, as it deems appropriate.

Thereafter, Virginia Power will disseminate the RFP approved by Staff broadly within the interested marketplace by publication in appropriate newspapers and trade journals, by distribution via the Internet, and by direct delivery of the RFP to the Virginia Independent Power Producers ("VIPPP") and other parties in this case, to parties that have previously entered into purchased power contracts with Virginia Power, to surrounding utilities, and to other organizations of potential suppliers. Responses for the capacity need identified for

July 1, 2000, will be received and considered on an expedited schedule set out below, while the solicitation process for the 2001 and 2002 capacity may occur at a more measured pace. The Company is, however, free to include the 2001 and 2002 capacity requirements within the RFP to be issued in conformance to this order, with notification that the scheduling of responses and evaluation of these bids will be issued separately.

We again caution Virginia Power, as we did in our January 1988 Order, to "guard against the temptation to make an RFP overly restrictive in terms of the types of projects which could reasonably meet the threshold requirements. It is important that the process give a fair opportunity to all participants."¹¹ We direct the Company to consider any and all options that might reliably meet the identified need, including those that would utilize power wheeled into Virginia Power's service territory making use of the Company's available transmission capability as identified during the hearing.

The RFP shall clearly state preferences for purchased power arrangements such as the nature, operating characteristics and location of capacity. The Company may also include appropriate provisions for discouraging frivolous bids and for requiring surety for contracting parties. The Company should consider

¹¹ 1988 S.C.C. Ann. Rep. 298 (footnote 3).

bids for offers of up to 30 months, for offers to meet the July 1, 2000, need. Provisions for extending such arrangements should also be considered by the Company.

The Company shall compare any offers so received against the benchmark cost of its proposed units as set out in its Application as amended. We agree with Virginia Power that non-price factors should be weighed less heavily than in earlier solicitations. However, we believe that reliability is an appropriate non-price factor for consideration. For example, "iron in the ground" within the Company's control area should be viewed as being more reliable than a proposal for firm energy from an unspecified source. Consistent with the market power concerns raised by the Staff and other parties, mitigation of Virginia Power's market power is another non-price factor for consideration. We will grant an exemption from consideration of additional non-price factors, to the extent such consideration is mandated by the Rules.

We further agree with the Company that, since the RFP to be ordered herein may generate a wide variety of offers, it should be exempted from the Rules' requirement of issuing a form purchase contract together with the RFP.

If the Company's build option is the successful bid (and its testimony indicates strong confidence that it will be), Virginia Power will be required to install the capacity at a

capped price not to exceed the amount set out in its testimony and Application. This "price cap" is needed to ensure that the Company's and any potential bidder's financial risks are comparable.

Virginia Power's witnesses all expressed strong belief that the market will unlikely be able to supply the entire increment of July 1, 2000, capacity at prices below the build option. The witness for the Old Dominion Electric Cooperative, Mr. Kappatos, voiced a similar opinion, as did the Staff. If, as is believed by these entities, this is the case, then evaluation of any responses to the RFP for the July 1, 2000, block of capacity should not be difficult. However, the Commission finds that the Rules, and sound policy, dictate that the market be provided the opportunity to express itself through the bidding process.

The Commission also finds that the Company's contention that there is a critical need for additional capacity in the summer of 2000 is well-founded. In order to meet this need, the Commission will, pursuant to § 56-234.3 of the Code of Virginia, conditionally grant the Company the authority to make financial expenditures for the proposed units at its Remington site in Fauquier County. Virginia Power is authorized and directed to begin such necessary permitting and site preparation work as needed to ensure the timely installation of the proposed combustion turbines. The Company is to continue such activity

during the pendency of the bidding process, at its expense and risk, until such time as the Commission orders differently. The Company is further directed to maintain its ownership of the combustion turbines while this action remains pending. The authorization granted herein is conditioned upon the bidding process uncovering no superior bid or bids for the supply of the needed capacity.

The Commission directs its Staff to review offers for capacity for July 1, 2000, and to report to the Commission as set out below the results of its review of the Company's evaluation of said offers. If no superior bids are received, the Commission will issue to Virginia Power certificates of public convenience and necessity by further order, which may impose additional conditions relative to the Company's use of the units.

Should reliable suppliers willing to meet the capacity needs at lower prices come forward, the Commission will issue a further procedural schedule. We expect and direct Virginia Power, however, to begin immediate negotiation to finalize an agreement with any such supplier who comes forward in response to the solicitation and offers to meet any portion of the identified capacity need at a superior price. Such negotiations, if any, over final contract details need not await the establishment of the further procedures contemplated herein.

Accordingly, IT IS ORDERED THAT:

(1) Virginia Power shall, no later than January 19, 1999, at noon, deliver to the Commission Staff its proposed Request for Proposals ("RFP");

(2) Staff shall review and, if necessary amend, the RFP and return the document to Virginia Power on or before January 21, 1999;

(3) Virginia Power shall immediately cause the RFP approved by Staff to be published and distributed as discussed herein;

(4) Interested parties shall submit to the Company, and may submit to the Commission's Division of Energy Regulation, responses to the solicitation for the July 1, 2000, capacity on or before March 26, 1999;

(5) Staff shall file with the Clerk of the Commission on or before April 2, 1999, a preliminary report detailing whether it appears that any responses so received indicate supplier or suppliers willing and able reliably to meet the need at prices below the Company's build option, and if so, how much further analysis of such offer or offers is required;

(6) To the extent that the requirements of this Order do not comply with the Rules, appropriate exemption therefrom is granted;

(7) The financial expenditures of Virginia Power proposed herein are approved, conditioned as set forth herein, pursuant to Code of Virginia § 56-234.3; and

(8) This matter is continued for further order of the Commission.